THE CATHOLIC FOUNDATION

Customizing for the Best Fit: Blended Gifts

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Customizing for the Best Fit: Blended Giftsc

"Were you born in a barn?" This reproach was traditionally leveled at someone who left a door or a window open or was guilty of some other inappropriate or negligent behavior. Thanks to the rise of barndominiums, however, this saying may soon lose some of its clout. Barndominiums are a social media sensation with those interested in custom fixer-uppers. This residential, custom-home concept combines the structure of a barn with the design features of a modern home or condominium.

The tremendous space offered by barndominiums provides the framework for endless modifications that would not otherwise be possible in a traditional home:

- A 20-foot-long steel kitchen island with full plumbing? No problem.
- A 2,500-square-foot workshop off the family room to store all the owner's 4-wheel and 2-wheel toys? Done.
- A 25-foot long by 9-foot high sliding glass entrance door that can be protected behind a roll-down steel door? Got it.
- An arena where show horses can run? A barndominum has room for that, too!

At least one architectural website claims the versatility of a barndominium makes this structure a good choice for almost anyone.[1] Donors looking for similar scope, versatility, and customization may turn to blended gifts—a giving technique that lets donors make substantial gifts that are tailored to their individual needs, circumstances, and goals. This issue of *Techniques ADVANCED* reviews the basic components of blended gifts and uses a number of realistic blended gift scenarios to highlight how this giving method can broaden a donor's philanthropic options.

The Appeal of a Blended Gift

A blended gift is not a type of charitable gift, but rather a technique that combines two or more types of gifts that together uniquely address the donor's financial situation and charitable goals. Finding this "perfect combination" lets donors make a more substantial gift than might otherwise have been possible, which benefits both the donor and the charity. And while there are no limits on possible gift combinations, most blended gifts pair an immediate donation with a future contribution.

With such tremendous flexibility, a donor at almost any age can choose gifts that work best within their own specific parameters—available assets, timing needs, tax considerations, and philanthropic goals. For example, a young, unmarried donor might make an immediate cash gift combined with a testamentary gift. A married donor with family commitments might combine an immediate gift of appreciated securities with a charitable remainder trust. A donor heading into retirement might pair a charitable gift annuity with a testamentary gift.

The first step for any donor seeking to design a blended gift is to understand the available options. Let's review the most common giving tools along with the benefits they can provide to donors structuring a blended gift.

Immediate Gifts

Many donors want to make an immediate impact on the charities they value and support. This is the most common and straightforward part of a blended gift. For such gifts, deductibility is a consideration for donors who itemize. While most donors understand the charitable income tax deduction, some may need a reminder that they will need a record of the gift in order to take the deduction—and more substantial gifts require even more detailed recordkeeping.

Cash

The most common immediate gift is a simple cash donation to charity. For a cash donation, the donor must maintain a record of the contribution, such as a cancelled check, a receipt, a letter from the charity (showing the charity's name, the date, and the amount of the contribution), or some other reliable written record documenting the same information.[2]

Property

As the value of the donated property increases, so do the requirements for documenting the donation:

- Over $500—the donor must include a description of the donated property with the tax return.[3]

- $5,000 or more—the donor must obtain a qualified appraisal and include an appraisal summary with the tax return. Additional records must be maintained for donations of non-publicly traded stock, certain publicly traded securities, or contributions by a C corporation.[4] The taxpayer must also maintain the general substantiation records required by Treas. Reg. §1.170A-13(b)(2)(ii).
- Over $500,000—the donor must obtain a qualified appraisal and attach a copy of the appraisal (not just an appraisal summary) to the income tax return for that year.[5]

IRA Distributions

Qualified charitable distributions (QCDs) allow donors over the age of 70½ to make a gift up to $100,000 (aggregate annual amount) from an IRA directly to a qualified charity. This immediate gift does not qualify for a charitable income tax deduction, but the distribution is free of income tax and it counts toward the donor's required minimum distribution (when one is due).

Deferred Gifts

Some donors can benefit greatly by including a deferred gift in a blended gift combination.

A charitable gift annuity (CGA) is a contractual agreement between the donor and the charity. In return for the donor's gift, the charity agrees to pay a fixed amount periodically to the person designated by the donor. This is useful for donors who wish to create a steady stream of income. At the end of the payment period, the remainder of the gift goes to the charity.

A charitable remainder trust (CRT) is an irrevocable trust. The donor contributes property to the CRT, the trust makes annual distributions to the donor or other named beneficiaries for a specified period, and when the trust term ends, the trustee pays out everything that remains in the trust to a qualified charity. This is also useful for donors who want to create an income stream—especially when their charity of choice doesn't offer charitable gift annuities.

A charitable lead trust (CLT) is also an irrevocable trust. However, after the donor contributes property to fund a CLT, the trust makes annual distributions to the named charity for a specified period. In general, the trust may not make payments other than to the charity until the trust terminates, at which point the trustee passes the remaining assets back to the grantor or other named beneficiaries (often the grantor's children or grandchildren).[6] This is a useful way to give when a donor wants his or her heirs to ultimately retain the assets.

Future Gifts

A blended gift often includes a testamentary gift in a will or a beneficiary designation of a retirement account, life insurance policy, or certain other assets.

Testamentary Gifts

Many people write a will as a fundamental part of estate planning—to dispose of their estate at death, direct their final affairs, or name a guardian for minor children. A will also makes it easy to direct a charitable bequest from the estate.

There are, of course, three types of bequests:

- **A specific bequest** is the gift of a specific asset to a particular beneficiary—for example, a donor who gives a particular work of art to a museum.
- **A demonstrative bequest** is one that identifies a specific amount of money from a particular source.
- **A general bequest** is a gift from the general funds of the estate after all specific and demonstrative bequests have been made. This type of bequest can be a specific dollar amount or a specified percentage of the remaining estate.

When a donor makes a charitable bequest, the gift can be a specific dollar amount, a particular asset, a stated percentage of the available estate, or even the estate residue (what is left after all other payments and bequests have been made).

Donors and their estates obviously want to benefit from a tax deduction for the charitable gift whenever possible. A bequest made to a qualified charity is deductible by the estate for estate tax purposes if it meets the requirements set out in the Internal Revenue Code (IRC).[7] To qualify for the estate tax charitable deduction under IRC §2055, a

bequest generally must be:

- Included in the decedent's gross estate,
- Transferred by the decedent by will, and
- Made to a qualified charitable organization as defined under estate tax rules.[8]

Of course, the term "qualified charitable organization" generally means any domestic or foreign "corporation or association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes" that will use the asset exclusively for charitable purposes.[9]

Beneficiary Designations

One of the most efficient methods of adding a future gift to a blended gift is to designate a charity as the beneficiary of retirement assets or a life insurance policy. This is an easy, straightforward, revocable gift. The donor fills out the beneficiary form and names the charity as beneficiary. At the donor's death, the charity receives the assets or proceeds directly since the money does not pass through probate.

The donor has the flexibility to name the charity as the primary beneficiary (to receive the funds first) or the secondary beneficiary (to receive the funds only if the primary beneficiary cannot). The donor can also choose to pass a percentage to the charity and a percentage to heirs.

There is an additional tax benefit to gifting retirement assets to charity and passing other assets to heirs. Neither the donor's estate nor the heirs will pay tax on the retirement assets—the money will pass in full directly to the charity. In contrast, retirement assets left to heirs are considered income in respect of a decedent (IRD) and are taxable both in the estate and to the heirs who receive them.

Selecting the Right Tools

Imagine you want to make a pie from scratch. For a nice flaky crust, you need to cut cold butter into the flour—a technique that incorporates the two ingredients while leaving consistently small lumps of butter in the mixture. You could pull two butter knives out of the drawer as a simple but somewhat awkward solution. Or you could spend $5 on a small handheld tool called a pastry blender to make the process much easier. Or you could buy a food processor that easily and efficiently produces just the right crumb-like mixture—but in addition to the $200 price tag, this bulky appliance is more difficult to clean and store.

Making a gift to charity often involves similar choices. Any basic gift will help fund the charity's mission, but some gifts may provide additional benefits for the donor and/or the charity. A potential donor should review all charitable giving options before deciding which tool will work best within a particular estate and financial plan. And as with baking, one tool cannot do everything—the most effective gift will often require a combination of giving tools. To see how this plays out in real life, it is helpful to look at several scenarios, from the simple to the complex.

Scenario 1: Immediate Gift + Testamentary Gift

Victoria (46) and Darin (47) were high school sweethearts who met in a school program where they learned to train guide dogs. They married young, opened a corner ice cream shop near their old high school, and continued their devotion to guide dog training. Not only did students flock to their ice cream shop, it soon became a regional hit. Over the years, they opened several more stores. Their success bumped them into the 35% federal income tax bracket (married filing jointly) and allowed them to set aside substantial amounts for the future, but the increased workload meant they had to stop volunteering. They decided to make a gift to the guide dog organization they volunteered with for so many years, but they hesitated to give away money today that they might need in the future.

Victoria and Darin determined they could contribute $20,000 to charity this year, but they were not certain that they could continue doing this year after year (as they would have liked). After meeting with the charity's gift planning staff, they determined their best option was to make the immediate $20,000 cash gift and also add a codicil to their wills to include a testamentary charitable gift of $250,000. They could change that amount in the future if their circumstances changed, but for the time being, it meant they were able to realize the substantial gift they wanted to make without jeopardizing money they might need in the future.

Scenario 2: Annual Gifts + Testamentary Gift

Irvin (38) was a trailblazer for young engineers, becoming the youngest CEO of an information technology company in his market. He wasn't able to spend as much time as he would like with his wife and two young daughters, but he was proud to provide them with the many perks that came with his new position, including a substantial salary of $750,000 per year.

Irvin never forgot the formative experiences he had in engineering school—in particular, the important people who taught, guided, and supported him during his college years. His parents had instilled in him a tradition of giving back, so when he became CEO, he decided to make a significant charitable donation to his alma mater. Initially, Irvin wanted to give the university $2 million. However, when he thought about his girls and the often-fickle nature of the IT industry, he found he was not comfortable making such a large immediate gift.

Working with the university's development staff, Irvin committed to a series of smaller annual gifts—$50,000 per year over the next 10 years, for a total of $500,000. Irvin and his wife file a joint tax return, so if they itemize, the charitable income tax deduction may save them approximately $18,500 per year. In addition, Irvin added a $1.5 million testamentary gift to his will—an amount that brings him up to his initial desired donation of $2 million. Irvin is confident that his worth will increase over time, and if so, he knows that he can always extend his annual giving past 10 years or increase the size of the testamentary gift.

Scenario 3: Immediate Gift + Charitable Gift Annuity

Lucia (55) owned a rock shop where she sold a wide variety rocks, fossils, and crystals. Her business really took off once she began making stunning and unique pieces of jewelry using items in her store. She acquired a very loyal customer base, both locally and online. At age 50, she wrote a beginner's guide to making jewelry with rocks and followed it up with a second book for those with more advanced skill. The two books brought in a total after-tax payment from her publisher of $1.5 million. Lucia had a strong desire to give the whole amount to her favorite environmental charity.

However, while she fully expected her business to continue thriving, she had started thinking of retiring in 15 years. After watching her own parents struggle with money in retirement (mainly thanks to some recent health issues), she worried about how comfortably she could live during retirement and how long her savings would last.

Lucia spoke with a gift planning specialist at the charity and learned that they offer charitable gift annuities. She decided to make an immediate cash gift of $500,000 and combine it with a deferred gift annuity of $1 million. This combination let her make a substantial gift, but it also provided her with guaranteed income during retirement.

Lucia purchased the charitable gift annuity and was able to enjoy a charitable income tax deduction for the year of the gift (since she itemized). She chose to begin annuity payments in 15 years, at age 70, at the offered payment rate of 6.7%. Each annual payment would be partially a tax-free return of principal and partially ordinary income (which is taxable). Since she used cash to purchase the annuity, none of the payment would be considered capital gain income.

Allocation of Basis

Charitable deduction:	$272,333
Payment rate:	6.7%
AFR:	0.6%
Annual payout:	$67,000
Ordinary income:	$22,378
Tax-free portion:	$44,622
Capital gain portion:	$0

Scenario 4: Annual Gifts + Beneficiary Designation

Berta and Isaac, both 65, had fairly successful careers as soul singers before opening a property/casualty insurance agency. They still receive royalties from their recordings, and their income from their small business puts them in the 37% federal income tax bracket. Their favorite charitable arts organization approached them seeking a much-needed gift of $3 million as part of a capital campaign.

Realizing that they could use part of their annual royalty payments to benefit the charity, Berta and Isaac entered a four-year pledge of $500,000 per year to the charity (for a total of $2 million) and also agreed to make the charity the beneficiary of

their second-to-die $1 million life insurance policy.

In their 37% federal tax bracket, if they itemize, the couple will save $185,000 a year, assuming the deduction limitations permit them to take the entire $500,000 deduction in one year. If total tax savings over the four years come to $740,000, the net cost of the $2 million gift is $1,260,000. And while there is no tax benefit to giving the insurance proceeds by way of a beneficiary designation, this is a very easy, straightforward way to give a substantial amount to charity without impacting money they might need during their retirement years. The proceeds will go in full directly to the charity without passing through probate.

Scenario 5: Qualified Charitable Distribution + Appreciated Property

Ken and Mei, both 72, are comfortably retired electrical engineers. They each accumulated substantial funds in IRAs from which they are now required to take annual taxable distributions. They also have three significantly appreciated commercial properties that they purchased 30 years ago using money from an unexpected inheritance. For 20 years, they were actively involved with a charity that helped children in need receive meals and school supplies. Health issues in the last couple years have caused them to significantly cut back their volunteer hours, and now they feel strongly about making a large donation to this charity.

Ken and Mei decide to each use their IRA to make qualified charitable distributions to the charity of $100,000 per year for five years. This will satisfy their required minimum distributions (RMDs), and they will pay no tax on the money, resulting in tax savings of $370,000 over the four years in their 37% tax bracket.

Ken and Mei also know first-hand that the charity needs new office space, and one of their commercial properties is a perfect fit. After speaking with the charity, they donate a property they purchased for $100,000 that is now worth $1 million. If they had sold the property, they would have owed taxes on the $900,000 capital gain ($180,000, assuming a 20% capital gain tax rate). By donating the property, they avoid the capital gains tax and receive a charitable income tax deduction for the gift, assuming they itemize:

Gift of real estate:	$1,000,000 ($100,000 cost basis)
Capital gains tax savings:	$180,000
Tax savings from charitable deduction (at 37%):	$370,000
Total tax savings:	$550,000

Scenario 6: Immediate Gift + Charitable Lead Trust + Testamentary Gift

Madeline retired at 60 from a corporate leadership job in the aerospace industry with a very large asset portfolio, and continued to receive significant revenue from her numerous patents on aircraft hydraulics. Local and then national television stations began asking for her expert comment on stories related to aviation and engineering, so at age 63, she began hosting a weekly aviation show on public television. With her producer's encouragement, she created entertaining and informative videos about the mechanics of flight and gained a large social media following. All her successful endeavors have kept her in the highest federal income tax bracket (37%) for many years. Madeline has two planning goals—provide financial security for her children (ages 30 and 32) when she dies and help meet the current and ongoing needs of her favorite charity (one that promotes STEM programs for underserved students).

Madeline had made smaller donations to this charity in previous years, but now, after meeting with the charity, she decides that creating a blended gift can effectively accomplish both of her specific goals. She decides to combine the following:

1. **An immediate cash gift.** Madeline makes an immediate gift of $1 million to help meet the charity's pressing current needs. If she cannot take the full amount of the charitable deduction in the current year, she can carry over any excess deduction over the next five years.
2. **A charitable lead trust (CLT).** Working with her attorney, her financial advisor, and the charity, Madeline funds a CLT with $5 million. The trust will make annual payments to the charity for 20 years, with an annual payout rate of 5% and an assumed AFR of 0.6%. In times of low interest rates, a CLT will

provide the donor with a better return, since in most instances the assets in the CLT will outperform the IRS assumed rate of return. At the end of the 20-year payout period, the remaining assets will pass to Madeline's children.[10] The result of her plans:

Potential tax deduction for Madeline:
$4,698,400

Charitable payment:
$250,000 per year for 20 years (for a total of $5,000,000)

Assets going to the children:
$6,839,280 (assuming 6% growth for CLT assets)

3. **A testamentary gift.** Madeline also includes a $2 million specific charitable bequest in her will.

This blended gift results in a total donation of $8 million to her cherished STEM charity. Meanwhile, her children should receive $6.8 million at the end of the CLT's 20-year term, along with the remainder of her estate (beyond the $2 million gift) at the time of her death.

Finding the Right Fit

The rise of online shopping created a corresponding expansion in the software used to help buyers find the best product to fit their needs. Many websites now go to great lengths to help shoppers find the most appropriate merchandise for their personal situation. While we've long been able to search by size or color or price, many searches go even deeper. For example, a search for pants might include information about size on the model shown, seam length, material choices, style, and cut.

As consumers, we have begun to expect this level of customization, so it makes sense that charities would likewise go to great lengths to help donors find the right charitable gifts to fit their personal circumstances and goals. Blended gifts fill this need for customization by offering all the alternatives available in the charitable giving toolbox, letting donors create just the right combination of gifts for the maximum impact and benefit.

This approach shows that charities understand this important concept: While everyone puts their pants on one leg at a time, not everyone wears the same pants.

ENDNOTES

1 "The Rise of Barndominiums and Why You Should Buy One," *Architecture Lab*, May 9, 2019. www.architecturelab.net/what-are-barndominiums/

2 Treas. Reg. §1.170A-13(a)(1).

3 IRC §170(f)(11)(B).

4 Treas. Reg. §1.170A-13(c)(2)(ii).

5 IRC §170(f)(11)(D).

6 Treas. Reg. §20.2055-2(e)(2)(vi)(a) and §20.2055-2(e)(2)(vii)(b).

7 IRC §2055(a)(2).

8 See IRC §2055(a), Reg. 20.2055-1(a).

9 Treas. Reg. §20.2055-1(a)(2). To help identify such organizations, the Internal Revenue Service maintains a non-exclusive informational listing of qualified charitable organizations in IRS Publication 78, *Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1986*. The online version of Publication 78 can be found at: www.irs.gov/app/pub-78.

10 Treas. Reg. §20.2055-2(e)(2)(vi)(a) and §20.2055-2(e)(2)(vii)(b).

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